Commerce 3/6

HIGH PRICES

and the Quantity Theory

BY

SIR JOHN O. MILLER
(Formerly of the Indian Civil Service)

La Monnoie est un Signe.
—MONTESQUIEU.

London:
SIFTON, PRAED & CO., LTD.
67, ST. JAMES'S STREET, S.W. 1.
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HIGH PRICES.

I.
INTRODUCTORY.

"The thing that hath been, it is that which shall be: . . . and there is no new thing under the sun."
—ECCLESIASTES.

HISTORY repeats itself, and for some time to come it is probable that questions connected with the currency will be canvassed and discussed with even more interest and, indeed, with more vehemence than in the period following the Napoleonic wars.

Then as now the country was faced with the problem of replacing its standard of value on a metallic basis, of resuming cash payments. The question of the best metal to adopt for the purpose had been considered with care and with much ability; the question of the effect of the decision on the relations of different classes of the community to each other, of consumer to producer, of labour to capital, of debtor to creditor had not been thought out with equal precision. Gold was adopted for the standard, and was introduced into the currency at a rate corresponding to its value in the days before the country had been obliged to have recourse to a paper currency.

Introductory.

The consequences that followed this decision, including the necessity of repaying in gold the debts that had been incurred in depreciated paper during the war, gave rise to discussions that lasted many years—discussions that were powerless to affect the policy that had been carried out, but that showed a wide interest in currency problems, and a surprising insight into their character.

The standard set up in 1816–21 was the monetary standard of the country up to 1914. Though it had then been in existence for less than a century, it had come to be regarded as amongst our most stable institutions. We were proud of the British sovereign, and of the Bank of England five-pound note; if not elements of the national greatness they were characteristic signs of it; they were an essential mark of our predominant position in finance and commerce. That other nations as they rose in the commercial scale should also base their currencies on gold seemed natural, and was a tribute to our foresight. We acquired the habit of regarding our currency as an absolute standard by which the values of commodities at different periods could be measured.

Even now, when faith in the stability of value of the pound has been rudely undermined, there is still a tendency to regard its pre-war value as something stable and constant; the restoration of that value or even an approach to its restoration would, it is thought, go far towards remedy-

ing the troubles from which we suffer. It is not generally recognised that even gold is not a stable measure, and that in pre-war days difficulties were arising from a slow change in its value. Gold was depreciating; prices were rising, slowly but steadily. Wages as usual responded more slowly to the change. Labour was quick to recognise that, in spite of its improved organisation, the real value of its remuneration was declining; there were threatenings of trouble, and even mutterings of a labour revolution; the discontent then engendered is responsible for much of the unrest and suspicion that now pervade the working-class world. There was no recognition however of the possibility that the currency might have a share in bringing about this discontent.

The very soundness of our currency, based on the most valuable of the suitable metals, has tended to distract attention from the theoretical study of currency questions. It has been more congenial to our methods, and has seemed more important, to investigate the fundamental causes affecting wealth, the laws of supply and demand, of increasing and diminishing returns, of the division of profits between labour and capital, than to trouble about alterations of value in the artificial medium into which the results of all such laws have to be translated. Even Ricardo failed to recognise the importance to the community of changes in the level of prices.

"Nothing," he wrote, "is to me so little im-

portant as the fall and rise of commodities in money; the great enquiries on which to fix our attention are the rise or fall of corn, labour or commodities in real value, that is to say the increase or diminution of the quantity of labour necessary to raise corn and to manufacture commodities."[1]

There is less general interest now in the theory of currency than there was when Ricardo wrote; the experience of the years following 1816 has been forgotten; and the country has again to face the problem that confronted it then, with an insufficient appreciation of all the consequences that may follow the solution.

"In the present state of economic instruction," says Professor Cannan, "there is no Government and no people, which is likely to understand what is happening,"[2] and it is a matter for congratulation that he and Professor Nicholson in their pamphlets on "Money," and "Inflation," should have come forward to throw light on the subject and to clear up many misunderstandings.

There is a difference, which must strike every reader, in the method in which these two writers approach the problem. Professor Nicholson expressly bases his argument on what he tells us is called the Quantity Theory, and has much to say of inflation of the currency; Professor Cannan does not mention the Theory and avoids the word "inflation." They arrive at similar results

1. "Letters to Malthus."
2. "Money," p. 55.

by different paths. Whether it is possible for a member of the public to take any useful part in the discussion may be doubtful, but it is of such vital importance at this time to have a clear understanding as to whether there is any law governing the value of a currency and if so what that law is, that any attempt however imperfect to stimulate interest in the subject may perhaps be excused.

There are some who question the Quantity Theory; there are many who give it a general assent, but do not accept all its implications; there are others who prefer to deduce its conclusions from the ordinary laws of supply and demand. In one sense it holds the field, for no other law has so far as I know been suggested in its place. If it is correct it seems to me best to treat it as a special law affecting currency, and not as a mere deduction from the general laws of supply and demand, and it may be that the presentation of the case, as it appeals to me, may influence others, who like myself make no claim either to the practical experience of the business man or the training of the economist. The fact that the currencies of the principal nations of Europe have now parted company with their metallic basis, and have no longer any definite value outside the country in which they circulate, should make it easier to form a judgment as to the truth of a theory, which asserts that the value of a currency depends, subject to certain qualifications, on its quantity.

The truth of this assertion may appear to some, as it does to myself, to be self-evident; others may ask for authority for it, and I have therefore quoted the words of some whose opinions carry weight; others again may find the best verification of the statement in its agreement with ascertained facts. My aim is not so much to dogmatise as to inspire doubt, to add to the number of enquirers, to suggest the far-reaching effect of any change in currency values, and the close connection of a stable currency with the security of the social fabric. I cannot hope to avoid errors both of substance and expression, but my purpose will be served if I can convey to others my own conviction of the grave importance of the subject at the present time.

If in dealing with prices I may seem to make too little allowance for changes affecting commodities themselves, improvements in production or transport, abundance or dearth, and to insist too little on the necessity for economy and for increased productiveness, the reason is not that their importance is overlooked, but that it is regarded as so obvious and as already so fully taken account of both by writers and in the reasoning of each one of us as to require no repetition.

II.
ON SOME WORDS.

"It was not by ideas—by heaven—his life was put in jeopardy by words."—TRISTRAM SHANDY.

WE can none of us escape from the domination of words, or hope altogether to avoid the pitfall of reasoning from some meaning of a word which has previously been employed in a different sense. Political economy has suffered much from this cause. It has not, except to a very limited extent, been able to invent terms for itself; it has had to appropriate words in common use and has then employed them either in a sense slightly different from their ordinary meaning, or in only one of several senses. Its doctrines have in consequence to be laid down with many qualifications and intimations that words must not be held to mean exactly what the ordinary man would suppose, and it is a mental effort to keep those qualifications constantly in view.

For example take the word "money." When prices are high the economist says that the value of money is low; when commodities are dear money is cheap, when they are rising in price money is depreciating in value. These are to him merely synonymous propositions; the same facts stated in different aspects. But the man of business attaches quite another meaning to

such a statement as that money is cheap. To him the words mean that the rate of interest on borrowed money is low, that the charge made for the use of credit is small. If the statement be made that money or gold is cheap, in the sense that prices are high, the practical man, finding, as may well happen in such a case, that the rate of interest is also high, may retort "cheap! what are you theorists thinking of? Has not the bank rate just been raised to 6 per cent.?" And even if for the sake of argument he professes to accept the economist's use of the term, he finds it difficult to get away from the ideas that he has always associated with the expression and distrusts any statement that conflicts with them. It must be admitted that the business sense of the term is the popular one, and that little is to be gained by striving against it.

A further reason for avoiding the term 'money' is that it is by no means certain what meaning the economists themselves attach to the word. Their laboured attempts to define it only tend to confusion, and one of the most distinguished was obliged to resign himself to the conclusion that "money is that money does." I therefore prefer the word "currency," by which I understand such money as is by the fiat of the State legal tender in payment of debts. The coins or notes of which a currency is composed I refer to occasionally as 'Counters,' of which there are two distinct classes, one which passes from hand to hand at its intrinsic value in the market, and

the other which passes at a rate that has no connection with intrinsic value. The sovereign up to a recent date was a counter of the first class, the one-pound note is a counter of the second. The note indeed is legally exchangeable for a sovereign, but in practice it is inconvertible, and anyone who habitually demanded gold for his notes would run the risk of finding the police take an annoying interest in his transactions.

Counters of the first class are referred to where necessary as 'commodity' counters or coins. The words 'sound money' express the same idea.

It does not often happen that coins are undervalued with reference to the metal composing them, but that is the case with both our gold and silver currency at present. Such coins cannot circulate without stringent police administration, which is in itself an evil. The coin, being worth more as bullion than as a counter, will be hoarded or melted down or exported to some country where it can be treated not as a coin, but as a valuable piece of gold or silver. It is no doubt for this reason that France has been unable to maintain an adequate circulation of small silver, and I have heard it said that in India an increasing coinage of rupees is accompanied by a decreasing number in actual circulation. No stringency of laws or efficiency of penal administration can permanently cope with the temptations to which the undervaluing of coins gives rise. The only remedy is to reduce

the value of metal in the coin, and probably this step would already have been taken in the case of our silver coin, but for a disinclination to arouse any suspicion that the currency was being tampered with. The public which had swallowed the one-pound camel might quite conceivably a short time ago have strained at the shilling gnat, but it is now prepared to accept the necessity for a reduction.

The word 'inflation' has been much in vogue of late, and when used metaphorically in such expressions as inflation of credit, or inflation of the currency, suggests vividly an operation similar to that of inflating a balloon. It insinuates a certain puffiness and instability, a liability to collapse; it calls up visions of a bubble ready to be pricked. Professor Nicholson says that inflation[1] is the name of a monetary disease, and defines it for his purposes as meaning "an abnormal increase of money." Such a definition, however, involves argument as to whether there has been inflation or not. Can we expect the authorities to admit that the currency is diseased? Who is to decide what constitutes an abnormal increase? After five years of war no one questions the fact of inflation, but long after inflation had begun there was no such unanimity. Many who admitted that there had been inflation of credit refused to adopt so ugly and immoral an idea as inflation of currency. The currency they said had been increased only to the extent

1. "Inflation," p. 48.

made necessary by the business of the country. Not a note had been issued more than the market required. There was no depreciation as compared with gold. To talk of inflation[1] in such circumstances was preposterous.

It is unfortunate that an expressive word should be rendered useless by being employed to connote ideas susceptible to perplexing argument instead of being confined to the expression of a simple fact, and I propose to use "inflation" as the best word hitherto devised to indicate that an addition has been made to the currency. I convey no sinister suggestion by the word; inflation may be good or bad, necessary or unnecessary; the point of real importance is the fact. For the metaphor of the balloon I would substitute that of the tyre, the inflation of which commences with the first stroke of the pump. The issue of a single new pound note is *pro tanto* inflation, albeit infinitesimal, of the currency of this country; the addition of a new full value gold coin is *pro tanto*, an inflation, though still more infinitesimal, of the currency of the world.

'Depreciation' and 'appreciation' are also words held to convey an unflattering meaning. We are ready to speak of the depreciation of paper, but hesitate to apply the term to gold. I use them, without any insinuations, to express a relation between the currency or gold on the one hand and commodities on the other, or be-

1. *See* Professor Cannan's admirable examination of these and similar arguments in "Money," pp. 55–58.

tween the currency in its present state and gold. If the prices of commodities generally, expressed in gold, are rising, gold is depreciating; a given amount of it purchases less. Gold has depreciated in America, though not so much as the pound has here.

When the price of a single commodity alters it is safe to assume that the cause is one affecting the commodity; when the prices of all commodities alter in one direction it is safe to conclude that the main cause is one affecting currency.

In contrasting the supply of gold or of currency with the volume of commodities exchanged by their means it is not quite correct to use the word 'commodities' without qualification. The number of transactions has also to be taken into account, and the expression Volume of Trade has been used elsewhere for this purpose. No serious misunderstanding is, however, likely to arise from using the simpler term in a pamphlet that does not pretend to scientific accuracy, and it has the advantage of expressing more vividly what is meant.

III.

THE PLACE OF CURRENCY IN THE SOCIAL FABRIC.

"Money, land, and woman are the three root-causes of strife."—EASTERN PROVERB.

PUBLIC opinion is slow to attribute to the currency any important influence on prices, still less to recognise its bearing on the relations of mankind in society. That a system of counters, adopted for convenience of exchange, should affect the material prosperity of the world, by stimulating or by paralysing its energy seems contrary alike to the teaching of economists as to the inevitableness of the laws of supply and demand, and to the precepts of the preachers as to the worthlessness of money in itself. Should there be a sudden change in values, some more recondite and dignified cause is sought for; it is only in the last resort and when other explanations have failed that suspicion falls upon the currency.

If we do not press the analogy too far a currency may be likened to the governor of a steam engine. The governor has no concern with the production of power; it is a mere intermediary between the motive force and the work done. Leave it untouched and the scientific investigator may neglect it in his calculations of the relation

between power and out-turn. It exercises a supreme controlling force, but the more perfectly its work is done, the less it attracts attention. Make, however, some change; lighten the balls that operate the throttle; they will be thrown upwards, will reduce the supply of steam, and retard the working of the machinery; add to their weight, they will open the throttle, the machinery will work more rapidly and more irregularly until there is a risk of its knocking itself to pieces. So with currency. As long as it performs its functions equitably it may be left out of account in considering the operation of economic laws. But restrict the supply and business is retarded; add to it and the wheels of commerce revolve more quickly. Beware, however, of adding too much lest the acceleration be greater than the fabric can endure.

Owing to this controlling influence, currency has always been a potent but unrecognised instrument of social revolution. Alison[1] in an ingenious essay has traced the connection between the failure of supplies of the precious metals and the gradual relapse of Europe into barbarism; the effect of the fresh supplies from the new world in the rebuilding of European civilisation is more generally recognised; Macaulay[2] questioned whether all the misery inflicted on the nation in a quarter of a century by bad Kings, Ministers and Parliaments was equal to the

1. "The Fall of Rome." Blackwood's, June, 1846.
2. "History of England," chap. xxi.

misery caused in a single year by bad crowns and bad shillings. The distress that followed the Napoleonic wars was not relieved till the gold of California and Australia began to circulate, and at the present day the Bolsheviks have used the indefinite depreciation of the currency as an essential instrument of their revolutionary programme. The power of currency as a social instrument is owing to the fact that through it the labour and self denial of the past that have made civilisation what it is are linked up with the struggles of the present and the hopes of the future.

The principles that govern the value of currency are therefore well worthy of investigation, and the lessons of history as to the effect of changes in that value deserve the attention of the politician as well as of the economist. Even should it be impossible to arrive, in the present state of our knowledge, at an agreement on the principles, it ought to be within our power to achieve a correct interpretation of the lessons.

IV.
EXCHANGE REGULATED BY CURRENCY.

"Société, c'est échange."—BASTIAT.

No one has pointed out the nature of exchange and of value so clearly as Bastiat. Society is based on exchange of services. By himself man can barely procure the necessities of the rudest existence; by association he has created civilisation as we know it. Man renders services to man, and, human nature being what it is, demands equivalent services in return. "One good turn deserves another."

"Value consists in the comparative appreciation of reciprocal services." The reciprocal service is not, however, always rendered at once, nor by the person for whom the first service was performed, and it becomes necessary therefore to devise some means for recording the value of the original service. Counters of some kind are required, and much has been written on the various devices resorted to in different countries and at different stages of civilisation. Montesquieu tells of an African tribe that employed a purely ideal unit of calculation, unrepresented by any material coin or commodity, and this practice could be matched from actual experience elsewhere. A series of notches on a stick might

serve where only two persons were concerned, but as the settlement of services came to be made between third parties, it was found necessary to have counters that passed from hand to hand and were generally acceptable.

Such counters may, as already said, be of two kinds :—

(1) Their value as counters may be in excess of their value as commodities ; in extreme cases their value except as counters may be negligible. Their acceptability may be due to custom, but is now always secured by the fiat of the State making them legal tender in satisfaction of debts.

(2) Their value as counters may be the same as their value as commodities.

Hence have arisen two different conceptions of the nature of money, which it is important to recognise. One school says 'Money is a sign,' or shall we say 'a counter?' The other which is more in accordance with the popular view says "Money[1] is an instrument which serves as a measure of exchange and is intrinsically an equivalent" or, more dogmatically; "Money must be made of a substance possessing intrinsic value, and that substance cannot be other than gold or silver."

These two methods of regarding money were brought into sharp contrast at an International Monetary Conference in 1881, where one of the

1. "La monnaie est un instrument, qui dans les échanges sert de mesure, et par lui-même est un équivalent." Chevalier, La Monnaie, sect. I.

delegates expressed the view that "Money is a merchandise weighed and verified by the State. Its value varies with the supply of and demand for gold and silver."

"No," said another delegate. "On the contrary Money implies numbers, and the value of its integers varies" (inversely) "with the numbers of them."

In my view the latter opinion is right. In essence money is a counter; in practice it may be a commodity or merchandise, and though its value then varies like that of other commodities in accordance with supply and demand, it does not escape from any rule that may be found applicable to the determination of the value of money as a counter.[1]

Those who are interested may find those rival conceptions set out in the pages of their supporters with a strength of language second only to that which is proverbially associated with theological differences. They will find logic commonsense and history invoked freely on both sides; they will find the same facts used to support opposite conclusions. They may read on the one hand how the ancient and admirable conception of money as a sign was lost in the darkness of the Middle Ages, and how modern nations, led astray by their abundant treasures

1. As Bastiat has been quoted it should be mentioned that he adopted the conception of money as a commodity. In his view exchanges were transacted by means of an intermediary merchandise: and "*cette marchandise c'est la monnaie.*"

of gold and silver, have never been able to recover it. Or on the other they will find it asserted that the ancients had a correct apprehension of money as a merchandise, (the high authority of Aristotle being appealed to), and that in the Middle Ages when the precious metals were scarce, the disastrous idea arose that money was only a sign. They will be warned, on the one part, to set their house in order betimes, lest a cessation of the supplies of gold and silver, or even a failure to discover new sources of supply, should lead to stagnation of commerce, industry and science; and, on the other hand, they will be advised to take to heart the distress that has inevitably resulted when mankind, on the advice of misguided enthusiasts, suffered itself to depart from the sound basis of metallic values.

Before the war it would have been difficult in this country to secure any support for the conception of money as a system of signs. The currency of all the great powers was based on a commodity,—gold,—and even when the stress of war necessitated the adoption of scraps of paper, the substitution was regarded as temporary. The notes were exchangeable for gold. Did not Parliament say so? Even now we continue to hope that, at some indefinite date in the future, it will be possible to exchange Bradburys for golden sovereigns of pre-war size and fineness, and some writers exercise their ingenuity in suggesting methods for supplying ourselves with the necessary stocks of the metal.

But doubts must surely be beginning to be felt, doubts caused by the increasing depreciation of the notes in relation to gold,—a depreciation that was concealed during war time, but that showed itself as soon as some of the shackles of that period had been removed. Doubts too as to whether the efforts and sacrifices necessary to replenish our supplies of gold may not have effects on our industry and finance of which inadequate account has been taken; doubts whether the proverb has been borne in mind that gold may be bought too dear.

For the time being, apart from the hope that the notes may some day resume their former value in gold, it is impossible for anyone to deny that our currency is in fact one of signs and not of merchandise, and the acceptance of this view may assist us to understand how the value of a currency is determined.

When we had a gold commodity-currency a simple solution was possible, but it added nothing to our knowledge of currency problems, and tended to some extent to mislead. The value of the currency, and therefore the level of prices, depended on the value of gold as a commodity. Gold was obtained for the currency at £3 17 10½ per oz., and prices were adjusted by the operation of the law of supply and demand so that the country could supply itself with a due proportion of the world's stock of gold at this rate.

The same law is extended by some writers to currencies consisting of valueless counters, but

while the result may be correct, the method of applying the ordinary rule of supply and demand to such counters does not appear to me to give the clearest explanation.

Value expresses a relation between two commodities. If one article, "A," is worth twice as much as another, "B," then in expressing that relation in counters it makes no difference whether we reckon "A" as 1 and "B" as ½, or "A" as 2 and "B" as 1, or "A" as 100 and "B" as 50. It is all a question of convenience of account, or if the reckoning is to be made in currency, of the sum of the counters available. It is a little more troublesome to deal in high figures, it may be much more troublesome to carry a large number of counters, but we can regulate exchanges with equal fairness on a high or on a low basis. The higher the level the greater must be the sum of the counters we have at our disposal, the lower it is the smaller need that sum be. Can we also assert the converse of this proposition? Can we say that the greater the sum of the counters in use the higher the level of prices must be, and that the smaller it is the lower will be that level. That is, as I understand it, the so-called Quantity Theory.

V.

THE QUANTITY THEORY.

"Wise sayings are not only for ornament, but for action and business."—BACON.

THINKERS of all ages have answered the question so put in no uncertain fashion. They scarcely regarded the theory as one requiring proof; they treated it as an axiom. They have confirmed the terse expression of the old Roman jurisconsult who said that the value of money depended *non tam ex substantiâ quam ex quantitate.*

There have been two occasions since the Revolution of 1688 when the currency system of this country had to be reconstructed, the first at the close of the seventeenth, the second at the beginning of the nineteenth century. On the first occasion the philosopher Locke was called into consultation. He had to apply his theoretical knowledge to practical purposes, and he advised the Government as follows:—

"Money, while the same quantity of it is passing up and down the Kingdom in Trade is really a Standing Measure of the falling and rising of other things in reference to one another. And the alteration of Price is truly in them only. But if you increase or lessen the quantity of Money current in Traffick in any place then the alteration of value is in the Money: And if at the same time Wheat keep its proportion of vent to quantity, Money, to speak

truly, alters its worth and Wheat does not though it sell for a greater or less price than it did before. For Money being looked upon as the standing measure of other commodities, Men consider and speak of it still as if it were a Standing Measure, though when it has varied its quantity, 'tis plain it is not."[1]

Montesquieu had met Locke in England, and had no doubt discussed currency questions, in which they were both interested, with him. The former was dealing with a specific practical problem; the latter was more concerned with general principles. Either for this reason, or because of the French aptitude for logical expression, he laid down more clearly than Locke himself the essential characteristic of the dependence of prices on the quantity of the currency. I have prefixed to this pamphlet his words, *La Monnoie est un signe* (*qui représente la valeur de toutes les marchandises*), and, with this idea before him he has no difficulty in drawing the conclusion that:—

"*L'établissement du prix des choses dépend toujours fondamentalement de la raison du total des choses au total des signes.*"[2] (The basis of the fixation of prices of commodities is the proportion between the sum of the commodities and the sum of the signs.)

Hume is no less emphatic:—

"It seems a maxim almost self-evident that the prices of everything depend on the proportion be-

1. "Letter to a member of Parliament (1691), para. 9, p. 22, Vol. II, Locke's Works, 1714.

2. "De l'esprit des Lois," XXII, ch. 7.

tween commodities and money, and that any considerable alteration in either has the same effect, either of heightening or of lowering the prices. Encrease the commodities they become cheaper; encrease the money, they rise in their value. As on the other hand a diminution of the former and that of the latter have contrary tendencies."

"If we consider any one Kingdom by itself it is evident that the greater or less plenty of money is of no consequence, since the prices of commodities are always proportioned to the plenty of money."[1]

The man whose researches had the greatest share in shaping the second reconstruction of our currency was Lord Liverpool. His Treatise "The Coins of the Realm"[2] was written with a purely practical object,—the remodelling of the currency on the lines to which we are all accustomed, the establishment of a gold standard. He was more concerned in discussing the relative values of gold and silver, and in weighing their comparative advantages for currency purposes, than in considering the laws of currency in the abstract, but even he, by accident as it were, ranges himself on the same side.

"As each of these metals (Gold and Silver) varies in its value with respect to the commodities for which it is exchanged, so it will vary for the same reason also in its value in successive periods, even with respect to itself, and this variation is occasioned by the greater or less quantity that may happen to be, at different times, in the market or in circulation."

1. Of Money.

2. "Coins of the Realm," chap. iii.

Ricardo[1] says :—

"I am of opinion that the increased value of commodities is always the effect of an increase either in the quantity of the circulating medium or in its power,—and is never the cause."

Very direct and explicit is Bagehot's statement, an *obiter dictum*, not directly connected with his subject, but inserted as a matter too obvious to require explanation :—"Within a country the action of a government can settle the quantity and therefore the value of its currency."[2]

One man of our own time, Sir David Barbour, put the theory into practice in changing the Indian rupee from a commodity to a token coin, and altering the Standard of Value from silver to gold. If the magnitude and the success of the operations he directed were fully recognised his opinions would carry more weight than any, and he has made them available in his work on the Standard of Value.

I have left to the last the opinions of John Stuart Mill, as they pave the way for explanation of the qualifications to be considered in interpreting the Theory. Mill, it should be recollected, lived during a period when currency questions excited the interest and awakened the controversies that are inevitable when society is experiencing the effects of a change in currency

1. Letters to Malthus.

2. "Lombard Street," p. 44, 8th edition.

values, and has been able to compare the working of a sound money system with inconvertible paper. His strength lay in setting out with precision and in logical sequence the conclusions of previous investigators; he may be relied on as representing faithfully the best conclusions at which the thinkers and practical men of his day had arrived.

At first sight Mill appears the stoutest upholder of the theory that the value of a currency depends solely on its quantity. No one has stated the theory with such precision, no one has propounded it in a more unqualified form. He over-reached himself in attributing to it "a greater certitude than the business of this world is capable of," and the inevitable reaction followed.

"That an increase in the quantity of money raises prices," he says, "and a diminution lowers them is the most elementary proposition in the theory of currency, and without it we should have no clue to any of the others";[1]

and he proceeds to formulate the following rule:—

"The value of money, other things being the same, varies inversely as its quantity, every increase of quantity lowering the value, and every diminution raising it in a ratio exactly equivalent."

And still more dogmatically:—

"If the whole money in circulation was doubled prices would be doubled. If it were only increased one-fourth prices would rise one-fourth."

1. "Political Economy," bk. III, chap. 8.

This last statement it would however be difficult to square with actual facts as observed by his readers, and Mill accordingly proceeds to relegate his rule to the class of theories that hold good only in the realms of Saturn. The public must not be so simple as to suppose that this rule applies in our modern civilised world, for there it would give "a totally incorrect expression of the facts." He does not explain why this is so; he does indeed refer to the necessity of taking into account 'rapidity of circulation,' but without much further examination he pronounces that:—

"In a state of commerce in which much credit is habitually given, general prices at any moment depend much more upon the state of credit than upon the quantity of money."

What then, the reader may ask becomes of 'the most elementary rule in the theory of currency'—the rule that gives the clue to all the others?

The answer is that the rule holds good if due consideration is given to the words "other things being the same." In practice they never are the same, and the effect of their variations now calls for examination.

VI.
QUALIFICATIONS OF THE THEORY.

"Dissertation,—ennui."—BASTIAT.

IN seeking for the solution of a problem the mathematician first of all attacks it in the simplest form which he can imagine. If for instance he is examining the laws of motion he begins by the assumption that gravitation and friction are non-existent; having established his general rule he proceeds to ascertain how it must be modified to allow for the operation of these and other disturbing elements. So too with such a theory as that of currency; but here it is possible to indicate only in a vague and general way what the disturbing forces are. Much closer investigation than has yet been given to the subject would be required to enable any trustworthy explanation to be given of the extent to which these forces affect the result.

When we are considering the effect on prices of changes in the cost of production or in the supply of commodities, we assume that the value of the currency remains unchanged. Similarly if we are examining the effect on prices of an alteration in the quantity of the currency we must assume that there has been no change affecting the supply of and demand for com-

modities. The first of these assumptions we make so habitually that we hardly regard it as an assumption ; the second is so contrary to all our experience, that we find great difficulty in making it at all. Throughout our lives we have been accustomed to account for changes in price by causes affecting the commodity concerned,—a change in the labour required, an unusual scarcity or a sudden demand. We have ourselves experienced the effects of bad harvests ; we have heard of the results of famine ; we may have observed the consequences of the arrival of a cargo much in demand ; our farmers know to their cost the effect of cheapened sea-transport ; we have benefited by the lowering of price caused by improvement in machinery, or the introduction of new inventions. Such causes are always present, and we naturally think them sufficient.

Imagine a great balance with currency in one scale and the articles exchanged by it in the other. If we add to the currency or diminish the commodities, the commodity scale goes up ; commodities have increased in value relatively to currency, prices rise. If we decrease the currency or add to the commodities prices go down. Ordinarily, however, we think only of the changes in the commodity scale ; and so constantly is this aspect discussed that I may be excused for concentrating attention solely on the happenings in the currency scale, without incurring suspicion of overlooking the effect which the com-

parative abundance or scarcity of commodities exercises on prices.

In connection with the currency scale the following qualifications of the rule have to be considered :—

(1) It is only the currency actually in circulation that affects prices. If hoarding prevails the amount hoarded has no effect.

(2) The rapidity of circulation or, as Mill calls it, "the efficiency of money" must be taken into account. One piece of money may be used for one hundred transactions in a year; another for only one. If two countries are exactly similar, except that the bustle and activity of the one lead to each coin doing on an average ten times the work that is possible in the leisurely conditions that prevail in the other, the latter would require ten times the currency of the former to maintain the same level of prices.

(3) There are various devices by which the actual use of currency may be economised. Cheques, bills of exchange, clearing-house arrangements are the most obvious examples. But for these the stocks of the precious metals available would not have sufficed to carry on the business of the modern world at the existing level of prices, and a general fall would have been inevitable. Cheques, etc., have exactly the same effect as currency so long as they circulate, but their course is soon run, and their efficiency is obviously not as great.

(4) Credit in general operating by means of

entries in accounts, deposits in Banks, and in other ways, must also be allowed for, and as we have already seen Mill considers this the principal agent in the determination of the level of prices in the modern commercial State. It would perhaps be more logical to regard such arrangements as dimishing the demand for currency than as increasing its supply.

When then the rule says " other things being the same," the meaning is that there is no substantial change in the volume of commodities or of transactions, that the efficiency of money does not alter, that the devices by which the actual use of currency is economised are not affected, and that there is no change in the spirit of confidence that governs the expansion of credit.

The currency may be regarded as a foundation on which a structure of credit is raised by means of various instruments and devices, which have for the time being the same influence on prices as if they were part of the currency itself. In the case of some of these instruments, such as bank notes, we cannot imagine any circumstances in which their validity would be questioned, others such as cheques and bills of exchange are less assured. How high the superstructure may be raised depends on the state of public confidence. If confidence disappeared entirely nothing but actual legal tender would be of any use. On the other hand if confidence is strong a small increase in the currency may, especially if the increase is likely to be continuous, encourage a much more

than proportional increase in the various instruments and forms of credit. It is the whole superstructure so formed and not the currency alone that determines prices; but the size of the superstructure is conditioned, though within very varying limits, by the extent of its currency foundation, and in the ultimate resort therefore it is on the amount of the currency that the level of prices depends.

When we enjoyed a gold commodity-currency the foundation itself was constantly varying so as to adjust the superstructure to the needs of the day. A great part of the currency was in the hands of the people, but by means of the reserves in the banks a vast amount of credit was supported. The reserves themselves were so small as to excite the admiration of all, and the apprehensions of many. Their regulation was effected through the operation of the bank rate, the adjustment of which, though not based directly on prices, had the effect of distributing the supply of gold in such a manner as to prevent any substantial variation in the level of prices in different countries. It did not prevent changes in that level caused by additions to the total supply of gold, but such changes were spread over the whole of the gold-using countries, and their occurrence was not generally recognised as an example of the working of the Quantity Theory.

With a paper currency, inconvertible into bullion, it is easier to understand that its value

must be regulated by its quantity. By what else can it be regulated?

By its intrinsic value? Obviously not. By the fact that the State has said that it may be exchanged for gold? Most people were quite ignorant, until a recent case called their notice to the fact, that they could insist on such an exchange; and even if they made it they would not be allowed to treat the gold as bullion.

By an indefinite expectation that it will some day be convertible into gold at the pre-war rate? Some such idea long prevailed and influences opinion even now, but the fall in value of the note as compared with gold must have come as a disillusionment to many, and the depreciation of the currencies of different countries in proportion to their over-issue must have prepared the way for a realisation of the theory that the value of a currency depends on its quantity.

Some may accept the theory for paper money, and yet may hesitate to apply it to a sound-money currency. To such I can only say that the opinions quoted in the last chapter, are, for the most part of men who were dealing with sound-money systems, and had probably not contemplated any other as permanent. Though based on abstract reasoning the theory accords better than any other with such ascertained facts as the rise of prices after the discovery of America, their rise in the Napoleonic wars, their subsequent fall, their rise after the gold discoveries of last century, their fall when Germany demon-

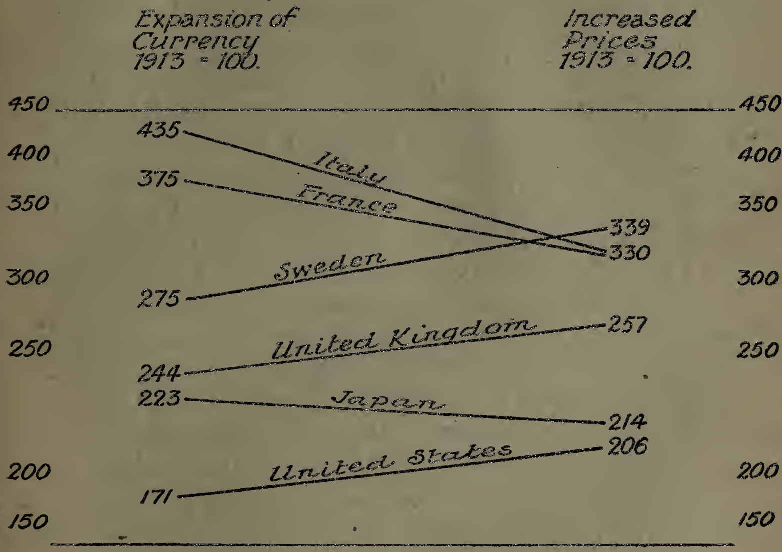
etised her silver, and their rise after the end of the century, when the treasures of the Transvaal, Western Australia and the Yukon became available. The changes so resulting were however gradual and world wide, and it is possible even for trained observers to explain them in other ways. Mr. Horne Tooke, who made an elaborate examination of the course of prices in the Napoleonic war, and subsequent years, an examination extending over many volumes, proved to his own satisfaction that all fluctuations could be accounted for by causes affecting the commodities themselves and not the currency. Even Mr. Tooke, however, would find it hard to resist the evidence of the connection between inflation of currency and prices recently given in a statement presented to Parliament, the main facts of which are reproduced in tabular form opposite.

The figures for Germany and Russia would form a useful pendant, but their general tenor is sufficiently well known. As the theory has been advanced that the rise of prices is due rather to the amount of government and especially war loans than to currency inflation, attention may be called to the facts :—

(1) That Sweden, which was not at war and where the increased debt was only £3 per head, shows a greater rise of price in proportion to currency inflation than any of the belligerents.

(2) That the ratio of rise of prices to inflation of currency differs very little in Japan, where the public debt increased by 3*s*. 3*d*. per head, and England, where it increased by £157 0*s*. 0*d*.

In conclusion it may be pointed out that the circumstances of war time were such as to give to the operation of the qualifications referred to on page 34 a more powerful effect than they



Command Statement 434.

would in ordinary times have in intensifying any inflation of the currency.

1.—*Hoarding*. There is much less temptation to hoard a paper currency than gold, and much less temptation to hoard at all when high rates of interest can be obtained for the use of money. Moreover, the conditions were such as

to place large sums of money at the disposal of classes that had never been in a position to hoard, and had not acquired the habit.

2.—*Efficiency of money.* That the rapidity of circulation increased is very probable. In times of rising prices everyone wishes to buy either to make a profit or to secure himself against a loss; and the amount of funds at the disposal of those who have to spend as rapidly as their means allow was enormously increased.

3.—*Devices for economising currency.* I have seen figures suggesting a great increase in the use of cheques in spite of the extra duty, and it may perhaps be legitimate to regard the use made of American securities to finance our purchases as a new economy (new at least in the extent to which it was carried), lessening the need for gold in international transactions.

4.—*Credit generally.* It seems reasonable to suppose that in ordinary times a larger superstructure of credit could be maintained on a gold than on a paper basis. The public assume that more gold can always be drawn from abroad by raising the bank rate, and as long as there seems a prospect of profitable employment of capital to justify the rise, no great difficulty is apprehended. If, however, the currency is of inconvertible paper and is limited in amount, apprehension might be felt that there would not be sufficient to meet further emissions of credit. Be this as it may, the conditions of war-time were different; there was no limit to the currency

issues, vast credits were given by the State, and the printing presses were ready to provide as much additional currency as was necessary to make the credits effective. There was thus no risk of a crash ; the Government could not allow one to occur. As regards other than government loans it is a truism that in times of rising prices all producers and speculators can obtain credit much more freely than in ordinary times. They pay more for the loans, but, as long as their operations are likely to be assisted by a further rise of prices, they can get them, and these credits help to bring about the rise of prices on which the borrower has calculated.

It would therefore have been no matter for surprise (even without taking account of the diminution in supply of commodities) if prices had risen in a much greater proportion than the increase in the currency itself. That the proportion is on the whole very much the same, a little more in some countries, a little less in others, is a remarkable feature in the Table on page 39 and it may be suggested that the real increase must be greater than the figures indicate, as these cannot take account of deterioration in the quality of the goods or services concerned. We pay more for inferior articles.

If the Table does not carry conviction nothing can be said that will do so. One is almost tempted to suspect the compiler of a wish to demonstrate the truth of the Quantity Theory.

VII.
EFFECTS OF GENERAL MOVEMENTS OF PRICES.

"Chaos is come again."—OTHELLO.

WHEN the tide is coming in, the change in the level of the ocean is too gradual to be perceptible. Wave follows wave, one coming a little further than the last, another falling short; we may have ceased to watch, when we suddenly find it necessary, like King Canute, to move our chair. Similarly the prices of different commodities are constantly rising or falling from causes affecting the markets, and it is long before a general movement up or down is recognised. When it is, every possible explanation is exhausted, before it is admitted that the change is not so much in the commodities as in the value of the currency. If prices are rising the consumers exclaim "profiteering"; if they are falling the producers lament "over production." Every change affects some interest injuriously; each interest has its own explanation.

Time is required to adjust all interests to the change. Meanwhile some gain or lose at the expense of others; all gain or lose unequally; and the losses rankle more than the gains delight. The countrywoman feels no particular pleasure in selling her produce at prices that she cannot

herself but regard as exorbitant, and will even apologise for the hard necessity that constrains her. When, however, she finds that with the proceeds she can buy no more cloths or stuffs than in the good old days of cheapness she feels aggrieved against the profiteers of Bradford or Manchester. The purchaser denounces the retailer, the retailer cannot understand why Government does not take order with the wholesaler, the wholesaler blames the rapacity of the producer, who in turn laments the increasing cost of production, the avidity of the wage-earner or the fall in exchange. The mass of the people are at a disadvantage compared with those who can handle the change to their benefit, and a feeling of bitterness spreads through the community. Hence spring class-hatreds, revolts against society itself, desires for a new order in which labour may reap a fair reward. While however any change causes injustice and unsettlement, the ultimate and permanent effects are of a different character according as the change is up or down. This is a point on which opinions may differ. The views I am disposed to take can be best illustrated from the vivid, and, perhaps at times, exaggerated, writings of historians.

Speaking of the effect of a protracted fall in prices, Alison in his essay on the Fall of Rome, says :—

" Gold, silver and copper were their sole circulating medium, and consequently when they were progressively withdrawn, there was nothing left to

take their place. Instantly as if by the stroke of a fell necromancer, disasters of every kind accumulated on the wretched inhabitants. Credit was violently shaken; money disappeared, prices fell to a ruinous degree; industry could obtain no remuneration; the influence and ascendancy of realised capital became irresistible; the only efficient power left in the state was that of the Emperor, who wrenched his taxes out of the impoverished hands of his subjects, or of the creditors and landlords, who by legal process, exacted their debts from their debtors and drove them to desperation. This was exactly the social state of the Empire in its declining days."

For a further picture of the degradation of society in the dark ages, and its connection with the degradation of money, the reader may be referred to the works of the American writer, Mr. Del Mar.

On the other side let us take Hume, who, speaking with special reference to the changes that followed the discovery of the mineral wealth of America, but throwing his remarks into a general form, said:—

"We find in every kingdom, into which money begins to flow in greater abundance than formerly everything takes a new face; labour and industry gain life, the merchant becomes more enterprising; the manufacturer more diligent and skilful, and even the farmer follows his plough with greater alacrity and attention."

Or this from Sir Walter Scott, when protesting against a proposal to restrict the Scotch currency by abolishing the one pound note:—

"Through means of the credit which this system

has afforded, roads have been made, bridges built and canals dug, opening up the most sequestered districts of the country, manufactures have been established unequalled in effect or success, marshes have been converted into productive farms, the productions of the earth for human use have been multiplied twentyfold, while the wealth of the rich and the comforts of the poor have been extended in the same proportion."[1]

While these pictures may seem overdrawn, there are some points on which there is not much difference of opinion as to the effects of falling or rising prices, and the following crude illustration will perhaps serve to indicate the method of their operation with sufficient accuracy for present purposes :—

A producer is considering whether or not he shall start a new venture, involving the use of borrowed capital. He estimates his annual outlay at :—

£A	..	interest on capital required.
£B	..	all other expenses, wages, salaries, cost of material, etc.

And his out-turn at :—

(A+B+C) articles or groups of articles fetching £1 each.

His profit is thus £C, which he considers sufficient to justify his embarking on the enterprise.

Now suppose that all prices are suddenly and simultaneously doubled.

His outlay is then	£(A+2B) ;
His out-turn fetches	£(2A+2B+2C) ;
His profit is therefore	£(A+2C).

1. "Letters of Malachi Malagrowther."

Prices having doubled he may reasonably expect to double his profit, but he gains a further advantage, because the charge for interest remains constant. The burden of that charge is lightened by one half at the expense of the lender. Production is stimulated.

Let us now take the opposite case, and suppose that prices fall to half what they were.

The outlay is then £ $(A + \frac{B}{2})$

and the out-turn fetches £ $(\frac{A}{2} + \frac{B}{2} + \frac{C}{2})$

the profit therefore falling to £ $(\frac{C}{2} - \frac{A}{2})$

The producer's profit in money is halved as is reasonable, but he suffers a further loss, as he has still to pay the same nominal amount as interest. The burden of his debt has doubled, and may even sweep away all the profit that he counted on. The lender gains at the expense of the producer. Production is discouraged.

The fact that in actual experience the change of prices is not simultaneous, but is gradual, tends to accentuate temporarily the gain or the loss of the producer as the case may be. Rents are usually fixed for long periods; rates and salaries do not alter quickly; raw materials probably respond more slowly to changes in the value of the currency than the finished article. In all these directions the producer stands to make a further gain when prices are rising, and to incur a further loss when they fall. It was formerly the same with wages; in the pre-war period, for example, when prices were rising, wages did not

keep pace with the cost of living, but in the exceptional conditions of the war, the order may have been temporarily reversed. It is reasonable that this should be so, as the inflation of the currency was necessary primarily for the payment of wages; it was mainly through that channel that the new supplies of currency came into circulation, and forced up prices all round. And in future it is certain that labour will demand an early adjustment of its remuneration to any new level. There is no need to insist on the scale of profits made by producers, in spite of excess profits tax, during the recent unprecedented rise of prices. Evidence of its extent meets us on all hands.

When prices are falling, wage-rates come down more slowly, and in all the large trades where they are fixed by agreement the tendency will be in the direction of still greater slowness in future, except where a sliding scale is operative. The result may be to accelerate the closing down of businesses when prices fall.

The general results may be fairly summed up as follows:—

When prices rise, the producer gains permanently at the expense of the holder of realised capital; he gains temporarily at the expense of all those to whom payments fixed for long periods are due; and in the past he has generally gained at the expense of the wage-earners.

The apparent loss of the wage-earner is however counterbalanced by the diminished risk of

unemployment, and by the competition for labour of the increasing funds at the disposal of the producers, making inevitable an eventual increase of its remuneration. More being produced there is more for everyone all round, and the standard of living is raised.

When prices fall, the holder of realised capital gains at the expense of the producer. The burden of all debts is increased, and the producer suffers a further loss, to the benefit of the salary- and wage-earners.

The apparent gain of the wage-earner is however counterbalanced by the increasing risk of unemployment; if prices continue to fall productivity must be checked, and less being produced there is less for everyone. The standard of living must fall.

Both conditions lead to friction and unsettlement. Both have their advantages and drawbacks.[1] The first increases productive activity, which may degenerate into rash enterprise and reckless speculation; the second promotes economy of working and inventive skill, but if long continued tends to stagnation. But both foster a sense of injustice, disturb social relations, set class against class, and cause actual distress in some part of the body politic. If we must choose between them, history seems to be in favour of a rise of prices, while economists fre-

1. The arguments *pro* and *con* on this subject are set out on pp. 33, 34 of the Report of the Commission on the Precious Metals. (1888).

quently appear to incline to a fall. Personally, I believe with the historians that a gradual and not excessive rise of prices promotes the material welfare of the world by reducing the weight of debt for the benefit of the productive classes, on whose energy all prosperity depends. All debtors are not producers, but practically all producers are, directly or indirectly, debtors, and their interests deserve more consideration than they have sometimes received from the economists. The Jewish dispensation endeavoured unsuccessfully to provide for them a periodical Jubilee; the rise of prices offers a similar but a gradual means of alleviation of their burdens. It lightens the weight which the past places on the shoulders of the present. A slow rise of prices seems therefore preferable to a fall, but sudden changes in either direction are disastrous, and the great need after the unsettlement of recent years is stability.

VIII.

REPLACEMENT OF THE PRECIOUS METALS BY A PAPER CURRENCY.

" And David said, ' I am in a great strait ; let me fall now into the hand of the Lord, for very great are His mercies, and let me not fall into the hand of man.' "—I CHRONICLES.

THE use of the precious metals in currency in ancient and modern times alike is due to their possessing certain qualities that have often been described ; such as divisibility, portability and indestructibility, combined with general acceptability. But at the present stage of development all the purposes of internal exchange can be equally well served by the use of counters or signs made of some comparatively inexpensive material or of paper, and paper notes have in fact been introduced as a necessity of the times in place of golden sovereigns. Gold has disappeared from internal circulation, and silver will in time disappear also, unless steps are taken to reduce the intrinsic value of the coins and make them as formerly mere tokens.

The change in actual use from gold to paper is in itself all to the good, and it may be doubted if there is any general desire to revert to the sovereign for ordinary purposes. Just as in Scotland, where, towards the close of the last century, the description of Sir Walter Scott still

held good that gold coins were never seen "unless in the purse of an accidental stranger or in the coffers of the banks," and that "a tradesman will take a guinea more unwillingly than a note of the same value," or, as in the Eastern States of North America, where notes had completely ousted gold before the war, so too in the whole of Great Britain the experience of the war has shown that a gold currency is superfluous for internal purposes. The use of such a currency has, however, an incidental advantage; while the adoption of a precious metal as the standard has a superiority that is, in the present stage of our knowledge of currency-problems, of the utmost importance.

The incidental advantage is that a gold currency provides a large stock of the precious metal for international use in any emergency. This object, however, the importance of which is unquestioned, could be equally well, and more economically attained by the maintenance of a sufficient stock of bullion in the banks. The other advantage must be referred to at greater length. The use of gold as the standard limits the supply of currency, and thus tends to keep prices comparatively stable. The quantity of gold already in existence is so large that the effect of an increase or diminution in new supplies is modified, and, as these supplies are spread over the whole of the gold-using nations, any unsettling effect on prices is brought within comparatively small limits. The fact, however,

should not be lost sight of that the value of gold, and therefore of the currencies based on it, varies. The depreciation of the precious metals after the discovery of America is the most strking example, but other illustrations of changes that brought in their train unsettlement and distress, and occasionally social disorders, can be added from recent history. The return to 'sound money' after the Napoleonic wars led to appreciation of gold, in other words, to an era of falling prices, from which the gold discoveries in the fifties brought a temporary relief. Silver was then in use as well as gold, a fixed ratio between the two metals being maintained by the Latin Union, but after the Franco-German war the Germans demonetised their silver, the Union gave up its attempt to maintain the ratio, the burden thrown on gold was increased, and its value again appreciated. The exchanges with silver-using countries were disorganised; a Commission was appointed to examine the relation between the two metals, and others to investigate the Depression of Trade and Industry and of Agriculture; it is hard to say what the end would have been, but for the unprecedented output of gold that began towards the close of the century. The situation was eased; prices began to rise slowly but steadily; the prosperity of the country increased; but the evils inseparable from any change in values made themselves felt. The cost of living rose more rapidly than wages, and labour was disquieted by the outlook, though it never

thought of attributing its difficulties to any cause so remote as the mines of the Transvaal or Yukon. The precious metals themselves are thus incapable of furnishing a just measure of value, and yet society has preferred to leave its interests at the mercy of the vicissitudes of nature rather than to place them in the hands of men. It has preferred a commodity currency, subject to all the changes that follow the abundance or scarcity of the chosen commodity, to a currency subject to definite regulation by the State. It has preferred a currency, the value of which can be altered at any moment by the policy of some foreign State (as by Germany in 1871) to a currency regulated by the authorities of its own. It would rather submit to the inscrutable arrangements of Providence than suffer from the possible weakness or ignorance of its own rulers; and the experience gained in the war has shown its wisdom in the present state of our knowledge. None of the Governments of the belligerent States are free from reproach, but our own deserves credit for using its powers with greater moderation than the States of the Continent.

In olden times, monarchs going to war made free use of the treasures of their subjects. They melted their own gold and silver, they compelled their barons to do likewise; the conscripting of armies and the commandeering of treasure went hand in hand. At a later date they resorted to forced benevolences, or they reduced the amount of metal in coins, thus gaining a supply for their

own purposes. Their action, however arbitrary, was at least open and above board. Our modern Governments attain the same end by the simpler, but more insidious, device of issuing notes. They gain at once the value of the coin removed from circulation. They increase the issues till prices rise, and by this process, as we have seen, lower the value of all realised capital and of all fixed payments, including salaries and wages. They appropriate the property of the subject as certainly as the monarch did of old, or they transfer it from one class to another, but they do so by hidden methods, and it may be doubted if they themselves clearly realise the result of their action. In their debates they discuss the morality of confiscation; in practice they resort to it without a thought.

When the safety of the State is in jeopardy, the property of all its members is rightly held to be at its disposal, so far as it is required to ward off the menace. But it is essential, to prevent discontent, that appropriations should be made on some system of equity; the process should not benefit one class at the expense of another; above all the method should not be obscure. Assuming that prices have doubled (they have in fact more than doubled), the State has reduced the burden of all its pre-war debts by one half. It has appropriated not only one-half of the real value of all these debts, but one-half of all salaries, pensions and the like to assist in meeting the expenses of the war. This was right and proper if all the

subjects were treated equally, but in fact they were not. All pre-war creditors have been subjected to a similar loss for the benefit not of the State, but of their debtors. All borrowers have been relieved of one-half of their burdens. The thrifty have been penalised; the man who set aside from his earnings enough to secure a competence for old age, or insured his life as a provision for his family, finds that his forethought and self-denial yield only half the comforts he had a right to expect. The exaction has been so made as to cause the maximum of distress to those who, through age or sex or the nature of their profession, cannot add to their income; to those who have given up business, to widows and young children, to the clergy, to charitable endowments of all descriptions. There is talk of a levy on capital. Such a levy has already been made on one class of property to an extent far exceeding any proposals publicly put forward.

With one exception the Governments of Europe have acted on no definite principle. That exception is the Bolshevik Government of Russia, which has carried out, clearly and logically, its purpose of destroying all property. Material possessions—land, houses, valuables—these have been forcibly confiscated; realised property in money has shared the same fate by the indefinite depreciation of the currency. If the rest of the world still hesitates as to the consequences of currency-inflation, the Bolshevik has no such doubts, and he is not slow to transform his

principles into action. His currency-policy differs only in degree and in its object from the measures of other States; it differs also in that he knew what he was doing, while they did not.

IX.
THE NEXT STEP.

"An increase in the purchasing power of the Standard of Value of 100 per cent., affecting all prices and wages, and unattended by any lowering in cost of production, would be an appalling calamity, whatever the cause of it might be."

BARBOUR. (1912).

THERE is a general demand now for a reversion towards the old scale of prices. The public generally, and labour in particular, look forward to a reduction in the cost of living; the Currency Committee recommend that the gold standard be made effective as soon as possible; Professor Nicholson advises the deflation of the currency; a leading politician its restriction; Professor Cannan more cautiously insists on "adequate limitation of the supply of money"[1]; Professor Pigou tells us that the best interests of the country require the restoration at the earliest possible moment of the note to full parity with gold.[2] The last proposal, which is that of the Currency Committee, means, if I understand Professor Pigou correctly, that prices would at once fall from 180 per cent. to 115 per cent. over the pre-war level, and this I believe to be an under-estimate. The opinion of financiers, economists and politicians thus agrees that the currency

1. "Money," p. 63.

2. "Contemporary Review," February, 1920.

should be handled in such a way as to bring prices down, and is therefore in full accordance with popular feeling on the subject.

The gravity of any such action appears hardly to be recognised. For good or for evil it will affect the life of the country for the next generation. We leave these matters to those who understand the handling of money, and who are able to give the best advice as to the avoidance of the difficulties that their special experience has made them familiar with; and we are all of us, as consumers, ready to welcome low prices. But any change in the value of currency produces far-reaching social effects, and in spite of the complexity of the subject, it is well to try to understand it for ourselves. More particularly is this advisable for the wage-earners, whose interests are the most important in the country, and in whose case the problem presents aspects of peculiar difficulty. Having had their wages fixed on the present cost of living, they will reap an immediate benefit from any fall of prices, and it will be a bitter disappointment if no such fall occurs. Professor Nicholson, whose judgment is entitled to great weight, holds strongly that labour benefits by falling prices, and makes light of the danger of increasing unemployment. I cannot so read the lessons of history, and would suggest that there is no subject that would better repay study by all interested in the welfare of the wage-earning class. They may be able to bring fresh light to bear on a question on which

there is at present no unanimity of opinion, and to show how the insidious effects of falling and rising prices make themselves felt among the mass of the population. It is possible, but I think improbable, that they may come to the conclusion that an era of falling prices is beneficial. My own opinion is that, serious as the evils have been that have accompanied the inflation of the last five years, they are as nothing to the tribulation that the country will suffer if we adopt the policy of reverting to a gold standard on the lines followed after the Napoleonic wars.

"Facilis descensus Averno,
Sed revocare gradum, superasque evadere ad auras,
Hoc opus, hic labor est."

We have the experience of the past to go on, but I am not acquainted with any examination of the effect of currency changes from the standpoint of the wage-earner in the first period referred to below. The following quotations represent the views of employers, but are none the less worthy of consideration, especially at a time when it is proposed to restore the note to full parity with gold.

In 1830 the ironmasters of Shropshire and Wales presented a Memorial regarding the effect of the fall in prices. Pig-iron had gone down from £8 to £3 per ton in five years, and other prices had fallen similarly, with the result, they alleged, that, in spite of all possible economies, including reduction of wages, the trade could not prosper.

"In our humble opinion the great cause which has been mainly instrumental in producing this depression and distress in our respective trades and among the productive classes of the country generally, is the attempt to render the rents, taxes, royalties, and the other various engagements and obligations of the country, convertible by law at £3 17*s.* 10½*d.* per oz. This low and antiquated price of the metallic standard of value is no longer capable of effecting a just and equitable distribution of our products between the producer and the consumer."[1]

These gentlemen of the past, labouring under a sense of injustice, gave vigorous expression to their feelings. The following is from an article written in 1832. It refers specially to the burden of taxes, but it is equally applicable to fixed payments of all descriptions:—

"Few of the sufferers can explain or understand how it happened, but the fact is very plain to them that they have somehow lost a good deal of money, and other persons have got hold of it. It is very clear that those who are in business pay nearly the same sum in taxes at present as when the goods they deal in sold for double their present prices; the taxes reckoned in goods, which is the only sure way of knowing their cost to the producers of goods by whom they are paid, are nearly twice as high at the end of sixteen years of peace, as they were at the close of as long a war. Is it wonderful, then, that the productive classes are labouring under severe distress?

"Pleasant, no doubt, it has all along been to the tax-receivers, the monied men and the placemen, to discover that while their income remained nomi-

1. "Quarterly Review," Vol. 47, July, 1832.

nally the same, they could purchase with it a much larger quantity of good things.

"But sad and ruinous have been the same times to the great body of taxpayers, the producers of these same good things, to the country gentleman of not overgrown estate, to the farmer, the tradesman, the merchant, the manufacturer, and the labourer, who found that, while they were obliged to pay the same nominal sum to the tax gatherer, they were every year receiving less and less for their goods, until at last scarcely anything is left for themselves."[1]

One more quotation, this time from Alison :—

"The change of currency in 1819, followed by the suppression of small notes in England by the Bill of 1821, had not only spread bankruptcy to an unparalleled extent through all the manufacturing towns, but had lowered by at least a third, sometimes a half, the money value of property of every kind in the kingdom. Hundreds of master merchants and manufacturers in every city in the empire had been rendered bankrupt, thousands of industrious artisans whom they employed, reduced to poverty or to the workhouse in consequence of these prodigious monetary changes. Every man whose property was burdened with debt soon found that debt assume a menacing, sometimes a crushing, magnitude, every person who lived by buying or selling—that is the whole trading community—found their commodities constantly getting cheaper on their hands."[2]

The connection of the social and political unrest of this period with currency changes is

1. "Quarterly Review," July, 1832.

2. "Lessons of the Past." (Blackwood, January, 1834; September, 1841).

forgotten now, but the sufferers recognised it at the time.

Another period of falling prices which will repay examination is that which was dealt with by the Royal Commissions of 1885 and 1893 on the Depression of Trade and Industry, and the Depression in Agriculture.

The Report of the earlier Commission undoubtedly lends support to Professor Nicholson's views, as the Commissioners, while definitely recognising in the fall in prices an important influence in bringing about the depression that they were examining, were clearly of opinion that the interests of labour had not suffered up to that time.

"There is no feature in the situation which the Commissioners have been called to examine, so satisfactory as the immense improvement which has taken place in the condition of the working classes during the last twenty years." (Para. 81).

A few years later the Royal Commission on the Precious Metals qualified its acceptance of this conclusion by adding :—

"Since the date of the Report in question there has no doubt in this country been further depression, especially in the employment of agricultural labour, and this depression has further tended to depress other branches of the labour market." (Part II, para. 23).

Some of the Commissioners thought this expression of opinion too restrained, and the conclusion to be drawn from this Report seems to

be that there had been a general advance in wages up to 1873, when it culminated. Thereafter increases in some cases had been accompanied by decreases elsewhere.[1]

A few years more passed, and the inevitable effect of a protracted fall of prices on wages became more apparent. Writing in 1892 Professor Foxwell said :—

"It would be easy to fill pages with the reductions in wages in the present year alone. Seven and a half per cent. reductions have been common with miners and quarrymen. The South Wales miners have been reduced 17½ per cent. under the sliding-scale; and a recent notice increases this to 28½ per cent.: Cumberland, Durham and Northumberland miners have accepted 10 per cent. reductions; 10 per cent. is a common reduction in the metal trades. Tailors in Leeds were reduced 25 per cent. in June. Agricultural labourers are suffering worst of all. In October the farmers of North-west Norfolk reduced wages to 11s. a week; and the general opinion seems to be that labourers' wages in the Eastern Counties will be generally at 10s. this winter. It is well known that a strike of huge proportions, already affecting 60,000 hands has commenced in the textile trades. Everywhere in short the outlook for labour is gloomy.[2]

And yet the total fall in prices in the years between 1866 and 1892 according to the Index Numbers of the Economist was only from a maximum of 139 in July, 1872, to a minimum of 92 in 1886. Contrast with this such a fall as Professor Pigou contemplates as the immediate

1. *See* pp. 114 and 135 of the Report.

2. "Contemporary Review," December, 1892.

result of making our notes convertible into gold (page 57, above). The consequences might well be disastrous. The complex relations of cause and effect in such matters will be judged differently by different observers, but enough has been said to show the necessity of full consideration, before the country is committed to any policy that deliberately aims at reducing prices by contraction of the currency. That there will be a fall owing to resumption of work and the greater abundance of commodities is probable, but with that I do not deal. I refer only to the policy of deliberately contracting the currency to bring prices down.

In the consideration of the subject it may be suggested—

(1) To the statesman :—

Any fall in prices must add to the burden of the immense debt that the country has contracted. A fall to pre-war level would mean more than doubling the real burden of that debt. In that case would not arguments for at least partial repudiation assume almost irresistible force? Moreover the great want of the day is the encouragement of production to replace the waste of war. Are falling prices likely to act as an incentive?

(2) To the wage-earner :—

The immediate benefit of a fall of prices is evident, and there is authority for the view that the ultimate interests of the wage-earning classes will not be adversely affected. History appears

to me to contradict such hopes. The interests of the wage-earner are those of the producer, and cannot be long separated from those of the producer-employer, in whose counsels the voice of labour is daily assuming greater influence. So long as unsettlement continues the wage-earners are at a disadvantage; when stable conditions are reached they can negotiate with the employer on equal terms.

To one class alone—those on fixed incomes—it is impossible to suggest any compensation for a policy aiming at stability rather than at a lowering of prices. Their case is the hardest of all; they have suffered injustice and are often in distress; it would only be adding insult to injury to suggest that, if the country accepts the present scale of prices as permanent, it may take steps to redress their hardships. It is true that they above all have been the victims of the policy followed in war time, but the important point now is not the interest of any one class, however inequitably it may have been treated, but the welfare of the nation as a whole.

Notwithstanding the strikes and rumours of strikes, the disputes and menaces and recriminations of which we hear only too much, there has probably never been in our history a time when there was a stronger desire on the part of all classes to understand each other, or when there was more courtesy, consideration and sympathy between class and class. To those who have spent their lives abroad the change effected

by education in intelligence and breadth of outlook, and reflected even in manners and bearing, is perhaps more striking than to those who have lived at home. That the elements of greater goodwill exist has been shown by the spirit that has so far, in spite of many openings for disorder, guided the country successfully through the trying times of reconstruction. It is unwise to submit this spirit to a further period of strain and unsettlement. No measures we may take now with the currency will repair the losses of all who have suffered; we may even confer fresh gains on those who have benefited already at the expense of their neighbours. We can no more remedy the pecuniary losses of individuals in war than we can bring back those whom it swept away on the field. It is well to hesitate before incurring the risk of adding another set of wrongs to those already inflicted, particularly if all the probabilities are that those wrongs will take the form of burdens, paralysing the industry and energy on which all hopes of the future are based.

There are many matters that require to be settled in terms of currency. There is the proposal to make a levy on capital, or an appropriation of war profits; there is the proposal to guarantee the farmer a minimum price for his wheat. More important than all is the adjustment of wages, which are no sooner fixed in one trade than they call for attention in another. At present prices are rising, and panting labour toils after them not altogether in vain; if prices fall

there will be a fresh struggle to maintain the industries of the country on a profitable basis. None of these matters can be usefully discussed or equitably dealt with unless we know where we are; unless we have some assurance that a pound will mean more or less the same thing ten years hence that it does to-day.

There is reason therefore for caution in accepting any proposals that aim at reducing prices by some operation on the currency. In the present state of knowledge on the subject it is probably advisable that we should revert to a commodity standard as soon as possible. But it does not seem probable that the stocks of gold can be adequate to maintain the present level of prices, even if new economies are introduced, such as the retention of the note for all internal purposes. The restoration of silver to its old place in international currency might afford some relief, but as not even the bimetallists have proposed this step, there may be some objection to it of which I am not aware. The only other suggestion that occurs to me is that the nations should recognise the fact of the changed value of gold in currency, and reconsider the rates at which it is introduced into the currencies of the countries that use it.[1]

1. Is it possible that the recent misapplication of the word "sterling" to the paper pound to distinguish it from the old sovereign is an instance of coming events casting their shadow before? "Sterling" is defined as "genuine, of standard value or purity," and its misuse to denote the absence of these qualities is to be regretted. But this misuse may suggest that the restoration of parity with gold could conceivably be effected by reducing the gold coin to parity with the new "sterling" pound, just as truly as by raising the value of the pound to parity with the old sovereign.

These, however, are practical questions on which I do not profess to form a judgment. What I question is the wisdom of initiating a new period of instability in a retrograde direction. It may be possible, at the expense of some disturbance of the money market, to effect such restriction of currency as will prevent prices from rising still higher, but the wisdom of going further is doubtful. Better to accept the situation, and resign ourselves to thinking in florins, where we formerly thought in shillings.

X.

CONTROL OF PRICES.

> "The economics of a king are of four kinds, whereof the first concerns money . . . that is, which coins should be raised or lowered in price and when."
>
> ARISTOTLE, "Economics."

IF prices are not kept down artificially by operations on the currency, there will inevitably be a demand for their control by the State, and if the Quantity Theory is correct, such control suggests an interesting illustration or deduction.

The Theory is that an inflation of currency involves an increase in the level of prices. If everything else remained constant, and the only change were in the currency, there would be a uniform increase in all prices.

But in fact this is impossible. Many prices are tied down by contract or by custom or even by public opinion. Rents, rates of interest, salaries, the cost of many services such as water or lighting, of travelling and freight, are prevented by one or other of these causes from rapidly reaching the height that they would otherwise have attained, and to which they will ultimately rise. If Government adds to the number by restricting the prices of commodities that would in ordinary course have responded to the inflation, it narrows still further the sphere in which the increase of the currency must operate. It

is as if one inflated an elastic tube that was strengthened in places by a non-elastic or less elastic band, so that these parts could not swell, or could not swell equally with the other parts. The tube would then swell all the more where not strengthened. If for example we control the price of flour when the supply is short, we set free a certain amount of purchasing power, which will increase the demand for something else, possibly for other cereals, the price of which bounds upwards. We extend our restrictions to all cereals; there is probably an increased demand for meat. We throw our net over all foodstuffs, and the extra sum set available may go to send up the price of clothing. We prevent all 'profiteering' in necessaries, and at once find an unaccountable demand for luxuries, and the prices of furniture, furs and jewels go soaring up. Recent experience lends some strength to these suppositions; and as a curious instance reference may be made to complaints that appeared in the press of the sale of damaged grain at prices exceeding those fixed for the sound article.

Interference secures a disproportionate profit to the producer of uncontrolled articles, and, short of compulsion, there is no means of preventing him from following his natural bent to make hay while the sun shines. The farmer will incline to the cultivation of uncontrolled crops, the fisherman to the catching of uncontrolled fish, the manufacturer to the production of uncontrolled articles of apparel. As the controlled

articles are those which are most essential to our welfare, the ultimate result of the restrictions is to divert industry to the production of those things that we can best do without.

In this country during the war control of certain prices was maintained to the great benefit of the community, especially in the case of food-stuffs. Lord Rhondda boldly announced his intention of flouting the ordinary rules of economics, and the result justified his policy, which met with a success unattained in any other country.

If the process could have been carried further, if it had been possible for the State to have conscripted the services, and appropriated for the time being the income, of all members of the community, and to have rationed the expenditure of each, the country would not now have to carry the burden of a debt of some 8,000 millions. Patriotism would have taken the place of profit as an incentive to work, and would, I believe, have proved a satisfactory substitute. It need not, however, be wondered at that such a complete break with the past was beyond the reach of any nation, and that no more could be attempted than to graft a modified scheme of price-control on a system which had its roots in the unrestricted exercise of individual liberty.

Complete success in such an operation was impossible. It early became apparent that control created difficulties, and that these could be removed only by more control. Retail prices could not long be controlled without some regu-

lation of the wholesale market; the regulation of wholesalers necessitated supervision over importers or producers; control to be efficient had to extend from the source of supply to the consumer. In enforcing such control the conditions of the United Kingdom during the war gave it certain advantages over other countries. It is easier to control imports than home-grown products, and the proportion of imported supplies to the total is larger here than elsewhere. The Government had under its orders the bulk of the shipping of the world, and was able in one way or other to exercise considerable influence over the remainder. Such a power must have been of value in negotiating the purchase of supplies. This advantage did not extend to the case of home-produced articles, but here again the Government had large exceptional powers, and it had also in its favour the patriotism of all classes, which made the people willing, to a far greater extent than is commonly recognised, to submit to regulations and restrictions opposed to all their traditional feelings as to the liberty of the individual. Even so, however, the terms that it was necessary to grant to the home-producers were often criticised as unduly liberal, and while prices were by the control kept down in the country as a whole, there seems little doubt that they were occasionally higher than they would have been had business been unfettered.

In peace times these advantages vanish. The foreign or colonial supplier has now the markets of the world open to him; and we must pay the

world-price or go without; the home-producer will not continue to work at a profit less than is earned by his neighbours. We are helpless in the matter of foreign supplies, except in so far as we may control freights, and the case of the home producer could be met only by compulsion. Compulsion indeed seems to me to be the *ultima ratio*, and if we wish to control effectively we shall be obliged to resort to it in some form.

At the same time it must be admitted that the effect of control on production is slower than might have been expected. Agriculture is the industry chiefly affected, but the farmer has his capital and knowledge locked up in a going concern, and cannot easily transfer them elsewhere. The only notable instance of a sudden cessation of production was the famous case of the rabbit, the disappearance of which was partly owing to seasonal causes. But long before production is visibly affected the effect of price restrictions begins to operate. The articles are not so good, or economies in transport or otherwise are secured at the expense of the consumer's convenience, or the trade finds other means of accommodating itself to the situation. A speaker connected with the trade put the point neatly and tersely, when he told a meeting at the Mansion House, that, if 1*s*. 9*d*. rabbits were insisted on, they would be forthcoming, but would be "dear at the price."

That control must ultimately affect production, unless the production can be carried on equally well under a system of compulsion, there

is no doubt. It is expensive, it is irritating, it hampers the free development of business, and must, in normal times, eventually raise prices above the level at which free competition would keep them.[1]

While attempts of the State to control prices of individual articles may be temporarily justified by exceptional circumstances, they are economically unsound, and ultimately harmful. But there is no function of a government more important than the regulation of the general level of prices. It is the duty of the State to see to it that the currency provided for the reckoning of the value of all services is so controlled as to secure justice and equity in the dealings of all classes of its subjects. Hitherto, to use words attributed to Mirabeau, the nations have been content to leave their interests "dependent upon the fertility of the mines and the avarice or caprice of their possessors," and the world is still without the knowledge necessary to suggest a means of escape. More light is wanted: and if our present troubles lead to further investigation of the subject in all its aspects, and to a wider diffusion of knowledge as to the laws that govern the working of a currency, they will not be without their compensation.

1. I am concerned, of course, only with control of prices, not with measures that might conceivably be better taken by the government than the trade to improve and possibly cheapen our food supplies in various directions (*e.g.* fish), or to introduce better methods of distribution, or negotiate international arrangements.

XI.
MISUNDERSTANDING AND MYSTIFICATION.

Populus vult decipi, decipiatur.

I HAD intended to give some examples of what appeared to me to be misunderstandings in the popular mind in approaching currency questions, but two must suffice. The first is unimportant—merely a straw to show how the wind blows : the second deserves more attention.

A recent letter to the press contained this statement :—

"Now a fall in prices can only come with an increased output of commodities,"

and the conclusion was drawn that the harder a workman worked, and the more commodities he produced, the worse he would fare under a sliding-scale, which regulated wages by the level of prices. It is, of course, correct that, the currency remaining the same, a fall of prices will result from the abundance of commodities, but it appears to be inconceivable to the writer of the above statement that a general fall may be owing, not to an increase of commodities, but to a decrease in currency. Most of us habitually think in this way, unless our attention has been speci-

ally drawn to the effect of changes in the currency, and the remark is interesting only as indicating the extent to which our habits of thinking expose us to the danger of being misled by high-sounding arguments, such as those employed in the next example, the speciousness of which misleads even the persons using them.

At one period of the war an eminent financial authority, after explaining to a meeting the connection between the mysteries of exchange and the level of prices, referred almost casually to the idea that the issues of Bradburys might have contributed to the latter. He did not think there was "much in it." Latterly opinion has seemed to be setting in the opposite direction towards a belief that there is "everything in it"; and it was somewhat startling to find the late Chancellor of the Exchequer range himself on the side of the financier. In addressing the shareholders of the Bank of which he is Chairman, Mr. McKenna is reported to have given it as his personal opinion that "the increase of currency is not the cause of high prices," and to have attributed the latter to the large amount of Government loans outstanding.

> "The loans of the State," he said, "have led to an immense increase of deposits, and as they have remained outstanding long after the commodities they were raised to pay for have been consumed, they have been the inevitable cause of a rise in prices."[1]

1. *The Times*, January 30th, 1920.

With all respect to the high authority uttering them, these words seem to me a good example of the process of explaining the simple by the obscure. We common folk are invited to accompany the financial aviator into the cloudy regions of the upper atmosphere, where only those who find it easy to think in thousands of millions, and who have some knowledge of the mysteries of finance and of the exchanges, can keep their bearings. We are not sure at times that we may not be flying upside down.

The ex-Chancellor's remarks have been received with general acclamation, and it must be my own fault that to me they are incomprehensible. It would interest me to know whether his pronouncement against currency as affecting prices is of general application, or is limited to our own position at the present time. For instance, it is inconceivable to me that anyone should believe that the depreciation of the rouble is not the direct consequence of the increase of the currency in Russia; it would surprise me to hear that anyone refused to admit a connection between the depreciation of the mark and the excessive issues in Germany; and I doubt if there are many who would combat very strongly the assertion that the statesmen of France and Italy have depreciated the *franc* and the *lira* by the additions made to the currencies of their countries. But the pound—that is another matter, and a deeper and more abstruse reason must be found. Galileo gravely suggested to a

troublesome enquirer that nature's abhorrence of a vacuum ceased at thirty-three feet. So, also, it would seem that the laws which are good enough for the rouble and the franc, quail before the majesty of the British pound.

There is so much that is admirable in Mr. McKenna's address that I should like to think that the difference between him and the many authorities whose views I have quoted, is only verbal, and the explanation may, perhaps, be found in the words which his successor used on two successive nights in the House of Commons. The present Chancellor of the Exchequer speaking on Wednesday, February 18th, is reported to have said :—

"It is not the currency which raises prices, it is the amount of credit which is created, etc."[1]

And on Thursday the 19th :—

"In so far as we call out hoards and pay for them in currency notes we shall tend to increase the number of notes issued in this country with consequential inflation, and increase in general commodity prices."[2]

Mr. Chamberlain thus specifically adopts the Quantity Theory on Thursday after throwing some doubt on it on Wednesday, and the explanation I conceive to be that both he and his predecessor intended their views to be understood in some such form as the following :—

1. *The Times*, February 19th.

2. *The Times*, February 20th, 1920.

"It is important to recognise that the ultimate cause of the rise of prices in war time is to be found in the enormous credits given. An increase of currency was required to make those credits effective, but that was only the proximate and not the real cause of the rise."

To this the only objection to be taken is that it obscures the issue, and if ultimate causes are to be invoked we may as well say at once that it was not the credits but the war that was the real cause of the rise. And this is exactly what Mr. Sidney Webb, fresh from his investigations into the price of tobacco, does say: "The increase in the cost of living is due in the main to the inevitable effects of the war,"[1]—a statement with which we can all heartily agree. The war could not be carried on efficiently without the increased credits; the credits could not perform their work without the inflation of the currency. If the views set out in this pamphlet are correct the inflation was an essential link in the chain of cause and effect, and was the immediate cause of the rise of prices.

I should be glad to think that the above correctly represents the meaning of statements that, in their reported form and without explanation, seem to me at the present time seriously misleading. But, taking the ex-Chancellor's remarks about loans as they stand, I would ask any who may read these pages to consider:—

1. "The Observer," February 23rd.

(1) How is it that prices have risen in Japan to nearly as great an extent, and in Sweden to to a greater extent than here? (*see* p. 38, above): and—

(2) How is it that prices rose in this country between 1900 and 1914 though the public debt was reduced from 771 millions in 1903 after the Boer war to 651 millions in 1914?[1]

1. "Command Paper," 429.

XII.
THE FOREIGN EXCHANGES.

(When the currency is depreciated and the export of bullion prohibited)
" there is theoretically no limit whatever to the price of bills."
—GOSCHEN.

IN all discussions about prices frequent reference is made to the Foreign Exchanges, and especially to the American Exchange. I should have preferred to avoid a subject of such abstruseness and complexity, in dealing with which the outsider had need to walk warily, but as the practical interests involved may necessitate some modification of the conclusions formed on a consideration merely of the internal working of a currency, I risk a few general remarks.

It sometimes happens that persons are willing to endure a considerable amount of discomfort and even of squalor in their own homes provided they can still keep up appearances in public. They can bear up against bad times indoors, but cannot reconcile themselves to the thought that their neighbours suspect them of going down in the world. Our attitude to the question of exchange is not altogether dissimilar. We chafed against the descent of the pound to something under half of its former value, but we did not take the matter too seriously, and we bore our troubles

with such philosophy as we could, as being the inevitable result of war. When, however, exchange began to crumble, when we had to face the fact that the pound had sunk to three-quarters or less of its previous value in dollars, we felt almost affronted; we began to suspect that there was something seriously wrong with our currency. To put the matter in popular, if not very exact language, we thought much less about a nine-shilling pound at home, than about a fourteen-shilling pound in America, and it did not occur to us that, but for the fact that the dollar has depreciated in America, we should have had a nine-shilling pound there also. A certain part of the fall in exchange is due to this, that the depreciation of the pound in this country has been greater than the depreciation of the dollar in America. The par value of the pound in dollars has changed.

But there is a further cause of depreciation that may lower the pound indefinitely below the new par level, whatever that may be.[1] When exchange falls below par in ordinary times the initial strain is taken by our gold reserves; the fall cannot long go below specie point. Now that it is impossible to settle our debts by export of gold, the only theoretical protection against an indefinite fall has been removed. In practice there is a limit, because American interest in the continuance of trade prevents the forcing down

1. *See* Goschen's "Foreign Exchanges," pp. 70 and 76 (13th edition).

of exchange to a level that would make trade impossible. It is to our interest at present to restrict our imports, it is to America's interest to export as much as she thinks we can be trusted to pay for, and the exchange is the resultant of these forces. At what rate it shall stand at any particular time seems to depend not merely on the balance between exports and imports at that time, but on the opinion that America may form as to our ability and determination to increase our exports so as ultimately to pay off the debts we have contracted. If we show signs of slackness, exchange will tend to fall, if we convince her that our energies are concentrated on increasing production, it will tend to rise. Some more definite means of securing stability is obviously required. A low exchange may not be without its advantages in discouraging imports; but a fluctuating exchange discourages trade altogether and has no advantage of any kind. As in the case of internal currency, the important point is stability, and if it should prove that stability can be attained only by some operation on the currency involving a fall of prices here, it might be advisable to face such a contingency, within reasonable limits, in spite of the disadvantages that I have ventured to suggest above. (Section IX).

The international side of the currency question is however outside my object.

XIII.
CONCLUSION.

"And now, my dear Malthus, I have done. Like other disputants, after much discussion, we each retain our own opinions."—RICARDO.

IT may seem to some that I have insisted unnecessarily, and with wearisome iteration and repetition, on the doctrine of the Quantity Theory, and the deductions to be drawn from it. It seems so to myself; but the examples given in Section XI, which could easily be multiplied, show that the Theory meets with no general acceptance, and that its truth is questioned by those to whom we may rightly look for guidance. If it is true, then its recognition is of vital importance to our welfare; and the addition of one more to the attempts made to explain it, though tiresome, may not be altogether useless. If it is untrue, it were well that the authorities who have held it in the past should be finally controverted, and no harm is done in marshalling their opinions for contradiction.

In looking through what I have written, I fear, lest in emphasising the baneful effects of a continuous fall in prices, and in suggesting that a day may come when civilisation may find some better means of regulating exchanges equitably than by putting all its trust in the output of the mines, I may be interpreted as being an advocate

of "cheap" money, and as favouring the views of those, who hold that money may be multiplied indefinitely with advantage, so long as it represents wealth in some specific form. That would be a complete misunderstanding. Such theories are possible, in my opinion, only where money is regarded as a commodity, as something which is "intrinsically an equivalent." From this conception spring the fallacies of those who think that money may be issued to any extent so long as it has some definite value behind it,—lands, or securities, or even public debts. They see no reason why such money should not be "good" as well as money representing gold. All such ideas would be swept away if we recognised that the value of currency as currency depends entirely on its quantity, and that the just regulation of that quantity is the prerogative of the State, and one of its highest duties. It would be inconceivable then that a local body should contemplate issuing a currency of its own, as the papers tell us has recently happened. Such a step would be recognised as an offence against the community,—the same in effect, though done with the best intentions, as the uttering of unauthorised coin. We shall not, I think, clear our minds on these subjects, until we recognise that whatever be the material of which it is composed, or on which it is based, nevertheless, in essence and reality

MONEY IS A SIGN.

POSTSCRIPT.

While these pages were in the press there was a debate in the House of Commons on the subject of expenditure, in the course of which Mr. Asquith is reported to have said :—

"There is no greater fallacy than to suppose that high prices are due to multiplication of the currency. It is the greatest nonsense, although it still finds favour in some imperfectly instructed quarters."[1]

Whether views expressed in such "imperfectly instructed quarters" as the works of the philosophers, Locke and Hume, the practical economists, Ricardo and Bagehot, and the currency-administrators, Liverpool and Barbour, are fallacious or not, it can hardly add to the reputation of the speaker to treat them with contempt. Used by a smaller man the words might raise a smile, coming from one of our most eminent statesmen they create a feeling akin to despair.

"Who but must laugh if such a man there be ?
Who would not weep if Atticus were he ? "

1. *The Times*, Tuesday, March 16th, 1920.